

# DEVELOPMENT BANK OF JAPAN

## SUSTAINABILITY BOND FRAMEWORK OVERVIEW & OPINION

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# TABLE OF CONTENTS

|          |  |           |
|----------|--|-----------|
| <b>1</b> | <b>PREFACE</b>                         | <b>2</b>  |
| <b>2</b> | <b>INTRODUCTION AND HISTORY OF DBJ</b> | <b>2</b>  |
| <b>3</b> | <b>SUSTAINABILITY BOND FRAMEWORK</b>   | <b>3</b>  |
| 3.1      | Use of Proceeds                        | 3         |
| 3.1.1    | Eligible Loans                         | 3         |
| 3.1.2    | Eligibility Criteria                   | 5         |
| 3.2      | Projects Selection Process             | 5         |
| 3.3      | Management of Proceeds                 | 5         |
| 3.4      | Reporting                              | 6         |
| <b>4</b> | <b>SUSTAINALYTICS' OPINION</b>         | <b>7</b>  |
| 4.1      | Conclusion                             | 9         |
| <b>5</b> | <b>APPENDICES:</b>                     | <b>10</b> |
|          | Appendix 1A: ERLP Assessment Topics    | 10        |
|          | Appendix 1B: ERLP Case Study           | 11        |
|          | Appendix 2A: GBC Assessment Topics     | 12        |
| <b>6</b> | <b>DOCUMENTS REVIEWED</b>              | <b>13</b> |

## 1 PREFACE

The Development Bank of Japan (“DBJ”) plans to issue a Sustainability Bond and has engaged Sustainalytics to review and provide an opinion on the bond’s sustainability credentials. As part of this engagement, Sustainalytics reviewed relevant public and internal documents of DBJ and held conversations with DBJ to understand the use of proceeds, management of proceeds and reporting aspects of its Sustainability Bond. This report contains two sections: Framework Overview – summary of DBJ’s Sustainability Bond framework; and Sustainalytics’ Opinion – an opinion on the framework.

## 2 INTRODUCTION AND HISTORY OF DBJ

DBJ is a 100% government-owned policy-based financial institution headquartered in Tokyo, Japan. Throughout its history, the bank has been devoted to regional development, environmental conservation, basic social infrastructure, and the creation of technology and industry.

The Japan Development Bank, the predecessor of DBJ, was established in 1951 to facilitate the reconstruction of Japan after the Second World War, specifically in relation to securing a sustainable energy industry. Soon after, its activities expanded to include infrastructure development, both nationally and internationally. During the 1970s and 1980s, as a result of growing social imbalance and increasing concerns in relation to the stable supply of energy, the Japan Development Bank focused its efforts on decreasing the gap in standards of living, pollution control, and regional and urban developments. During the late 80s and 90s the Japan Development Bank continued to support improvements to social capital. In 1999, the Japan Development Bank and the Hokkaido Tohoku Development Finance Public Corporation merged to form DBJ. It focused on three areas: community development, environmental conservation and sustainable societies, and the creation of new technologies and industries. In 2008, DBJ was established under the Development Bank of Japan Inc. Act (the “DBJ Act”).

According to its business model, DBJ “works to resolve the issues its clients face by providing specialised financial services involving integrated investments and loans.” It provides the following services:

- Loans: Provision of medium- and long-term financing, as well as project financing and other forms of structured and subordinated financing.
- Investment: Provision of mezzanine and equity financing
- Consulting/Advisory services: Arrangement of structured financing, provision of M&A advisory services, applying DBJ’s industry research function and expertise in environmental and technology evaluations.

Beginning with the antipollution measures implemented in the late 1960’s and early 70’s, DBJ has provided more than 3 trillion yen<sup>1</sup> in investments and loans for environmental measures. And in October 2014, in order to reinforce its commitment in the field of environmental conservation, DBJ issued its inaugural Green Bond. The 250 million euro three year bond was used to fund assets from DBJ’s ‘Green Building Certification’ programme. The Green Building Certification programme will also contribute assets to the envisaged Sustainability Bond’s pool of Eligible Loans.

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<sup>1</sup> [http://www.dbj.jp/en/pdf/CSR\\_disclo/2015/2015\\_all.pdf](http://www.dbj.jp/en/pdf/CSR_disclo/2015/2015_all.pdf)

DBJ plans to issue a Sustainability Bond as it seeks to diversify its investor base and connect dedicated investor demand with the sustainable parts of its business.

## 3 SUSTAINABILITY BOND FRAMEWORK

For this Sustainability Bond issued by DBJ, a framework has been created with a goal of providing transparency, disclosure and integrity of the bond issue. Although the bond will be a Sustainability Bond and not a Green Bond, the structure of this framework follows the four key pillars of the Green Bond Principles (“GBP”):

- Use of Proceeds
- Selection Process
- Management of Proceeds
- Reporting

### 3.1 Use of Proceeds

#### 3.1.1 Eligible Loans

The net proceeds of the issuance of the sustainability bond will be used exclusively to finance or re-finance, in whole or in part, existing and/or future ‘Eligible Loans’ from the following DBJ Loan Programmes and which meet the “Eligibility Criteria”:

- i) The DBJ Environmentally Rated Loan Programme (“ERLP”);
- ii) The DBJ Green Building Certification Programme

##### 3.1.1.1 DBJ Environmentally Rated Loan Programme

Based on knowledge cultivated through DBJ’s years of experience in investments and loans for environmental measures, DBJ initiated its Environmentally Rated Loan Programme (ERLP) in 2004. This programme incorporates environmental ratings into its lending products by evaluating the environmental management of its clients. A rating is then assigned on a letter-grade scale: A, B, C, D and None. As of the end of March 2015, DBJ had extended 472 ERLP loans.

The ERLP Rating Process follows three key steps:

Step 1: Preliminary Survey

- Clients are asked to fill in a preliminary survey sheet for negative screening.

Step 2: Full Assessment

- After the preliminary survey, DBJ will conduct its full assessment based on the research of public information of the company’s environmental efforts (for example a CSR Report).
- DBJ will then interview clients to collect non-public information on their environmental efforts.

Step 3: Rating and Monitoring

- Ratings will be assigned according to the points scored in the assessment.
- Clients enter into a covenant to maintain the level of environmental effort until redemption of the loan. If the covenant is broken, DBJ will review the rating.

The assessment incorporates the following key areas:

- General Management
- Business Activities
- Environmental Performance

The key areas are broken down into sub-sectors which are weighted for importance. DBJ provides loans to companies rated A, B, C or D and excludes companies rated “None”. In addition, for the companies that are rated A or B, DBJ provides a discount on loan interest rates (for companies rated C or D loans are offered at regular rates). An overview of the assessment topics is provided in Appendix 1A.

| Rating | Assessment   |
|--------|--|
| A      | Companies with excellent advanced environmental initiatives                              |
| B      | Companies with advanced environmental initiatives  |
| C      | Companies with sufficient environmental initiatives                                      |
| D      | Companies with sufficient environmental initiatives but additional effort to be required |
| None   | Ineligible   |

### 3.1.1.2 DBJ Green Building Certification

As part of its financing activities, DBJ offers “Green Building Certification” (“GBC”), in order to support its clients who own or operate real estate properties with high standards of environmental and social features. The certification is available for office buildings, logistics facilities, as well as retail facilities.

In order for buildings to be certified “green”, they must undergo an assessment by DBJ. This assessment is intended to ensure that the construction takes into account environmental considerations. Additionally, it ensures that the buildings take other responsible factors into account, including:

- Disaster-prevention and anti-crime measures;
- Tenants’ comfort and convenience;
- Harmony with the surrounding environment;
- Collaboration with stakeholders (including tenants and investors); and
- Environmental Investor Relations activities.

Once a property has successfully received the certification, DBJ will support the financial needs for new developments and refurbishments. Further details about the areas of assessment under GBC are provided in Appendix 2A.

As a result of the assessment, properties may receive one of the following certifications:

| Rating  | Assessment  |
|---------|---|
| 5 Stars | Properties with <b><u>the best class</u></b> environmental & social awareness     |
| 4 Stars | Properties with <b><u>exceptionally high</u></b> environmental & social awareness |
| 3 Stars | Properties with <b><u>excellent</u></b> environmental & social awareness          |
| 2 Stars | Properties with <b><u>high</u></b> environmental & social awareness               |
| 1 Star  | Properties with <b><u>satisfactory</u></b> environmental & social awareness       |

### 3.1.2 Eligibility Criteria

Eligibility Criteria are defined as:

- Loans to companies that are rated A, B or C under the Environmentally Rated Loan Programme
- Loans to (re)finance buildings that are rated 3, 4 or 5 stars under the Green Building Certification Programme and that were not allocated to the previous Green Bond proceeds.

### 3.2 Projects Selection Process

DBJ’s Treasury team is responsible for the selection of loans that meet the Sustainability Bond’s Eligibility Criteria and for the allocation of Sustainability Bond proceeds of the selected loans. All loans and corresponding ratings approved under ERLP and GBC programmes are tracked in an internal loan management system. This allows DBJ’s Treasury team to accurately identify and select the loans as per the Sustainability Bond Eligibility Criteria and allocate Sustainability Bond proceeds appropriately. These loans and bond proceeds allocated to them are recorded and maintained in a spreadsheet, which is used for tracking and reporting purposes.

### 3.3 Management of Proceeds

Management of unallocated proceeds: The net proceeds from the bond issuance will be held and tracked in DBJ’s treasury until they are allocated to Eligible Loans. So long as the Sustainability Bond is outstanding, DBJ aims to allocate an amount equivalent to the net proceeds of the Sustainability Bond towards Eligible Loans. Unallocated proceeds will be held in cash and/or a money-market portfolio which will be tracked by DBJ Treasury.

Tracking of proceeds: DBJ has internal loan management systems to track the amount of funds allocated to Eligible Loans.

### 3.4 Reporting

The allocation of the bond proceeds will be reported annually on DBJ's website. DBJ will disclose, on an annual basis, the total amount of loans provided under the ERLP and GBC programmes and the number of loans granted using the Sustainability Bond proceeds. In addition, in the case of the GBC programme where it has received client's consent, DBJ will disclose two or three cases studies of green buildings underlying the loans allocated to Eligible Loans. In the case of the ERLP, DBJ will report the sector distribution of clients and, in cases in which it has received a client's consent, it may report project summaries and key factors evaluated on specific green projects undertaken or implemented by the client.

DBJ will also disclose the amount of unallocated proceeds and the investments in which these proceeds are held.

## 4 SUSTAINALYTICS' OPINION

**Environmentally-focused organisation:** Historically, DBJ was always mandated to focus its financing activities on the environment with a focus on pollution prevention in the 1960s and 1970s, on environmental preservation in 1990s, and now on investment and financing activities targeting environmental conservation and sustainable societies. In June 2001, DBJ became the first Japanese bank to sign the UNEP Statement by Financial Institutions on the Environment and Sustainable Development. In addition, DBJ had developed a detailed Environmental Policy. Article 2 of this policy states that DBJ promotes environmental measures through loan and investment activities by supporting environmentally sustainable corporate management by its clients. In addition, ERLP and GBC programmes demonstrate that the integration of environmental factors in its financing activities has been a key focus area for DBJ.

**DBJ's Environmentally Rated Loan Programme ("ERLP"):** Sustainalytics reviewed DBJ's ERLP in detail and compared it with its own ESG rating methodology to determine if the ERLP adequately evaluates companies on key environmental aspects.

Sustainalytics reviewed the 15 assessment topics (see appendix 1A), all the indicators within the assessment items, evaluation criteria and the scoring to determine if these cover the wide range of topics and assessment areas covered by Sustainalytics' own ratings methodology. Key points from the assessment are below:

- Sustainalytics rates companies on 1) preparedness (commitment), 2) disclosure and 3) performance (qualitative and quantitative) which are typical areas of assessment in most rating methodologies. Although the questions in ERLP framework are not explicitly grouped under the above mentioned areas, they are adequately captured within each assessment item.
- The Environmental Performance area in ERLP aims to capture detailed information on quantitative metrics such as energy use, GHG emissions, water, waste, and other resource use. Sustainalytics views this as an area of strength in the ERLP methodology.
- The ERLP has different screening sheets for different types of companies such as manufacturing companies, leasing companies, retail trading companies, transportation companies, logistics companies and so on. This allows DBJ to carry out assessment relevant to a specific company type.
- Rating companies on commitment, disclosure and performance needs to be complemented by assessing companies on major ESG events or controversies. DBJ, aims to capture major ESG risks by asking companies to report such events as part of the rating and conducts its own research to identify companies' involvement in negative events.

Based on this assessment Sustainalytics is confident that the ERLP methodology adequately assesses companies on the key environmental issues and is effective in identifying the environmental leaders. Sustainalytics reviewed several companies that were rated as leaders by DBJ and found that they did not have any major controversies.

**DBJ's Green Building Certification ("GBC"):** DBJ initiated its Green Building Certification (GBC) programme in 2011 and, as of May 2015, had certified 183 buildings, 40 logistics facilities and 24 commercial facilities.



GBC is a certification that is independent from DBJ's loan, therefore, the GBC rating does not affect terms of the loan. However, only those loans that receive 3 stars or above will qualify as Eligible Assets in the Sustainability Bond Framework

In FY 2010, DBJ assessed a sample of Japan's REIT buildings (about 100 buildings) and the assessment resulted in about 50% of the stock akin to 2-star GBC-rated buildings and most of the highly rated buildings (as defined by other 3rd party agencies) were similar to 3-star GBC-rated buildings. This indicates that Japan REIT buildings with 4 or 5 stars under GBC programme have higher environmental performance than most buildings in Japan that receive top ratings from 3rd party agencies.

Therefore, by selecting buildings with 5, 4 or 3 stars, DBJ is allocating the proceeds of the Sustainability Bond to REIT buildings with top environmental performance in Japan.

**Impact:** The ERLP incentivizes companies to improve their environmental performance by providing discounted interest rates for top-rated companies. In addition, companies with ratings lower than D are not eligible for loans under the ERLP. Furthermore, DBJ updates the assessment criteria annually which could result in higher thresholds, thereby making it difficult for a company to achieve the same rating without making reasonable improvements the next time the companies borrows from DBJ. The fact that quite a few companies that had previously received ratings and loans under ERLP have returned to apply for loans under ERLP programme, and qualified under a more stringent assessment indicates the programme has contributed to improve environmental performance of the company. In this way, DBJ is encouraging its borrowers to continually improve their environmental performance. In addition, by having a minimum requirement for loan qualification and providing incentives for high performers, DBJ is providing a clear signal to the market that environmental impact is a key consideration for its lending products. Furthermore, the companies that receive high scores benefit from enhanced reputation among their peers.

With GBC, DBJ rates buildings based on improvements in energy efficiency, natural resource use, sourcing of renewable energy and third-party certification (LEED, BREEAM etc.), in addition to other factors such as amenities, risk management, community and partnership. According to DBJ, the interest in its GBC has increased over the years as property owners value the GBC certification as a way to differentiate their buildings from other buildings. Given this interest, DBJ has expanded its GBC to cover office buildings, retail and logistic facilities. Going forward, DBJ aims to foster a correlation between a building's GBC ratings and its economic value, creating a market in which green buildings are valued appropriately.<sup>2</sup> In addition, the GBC certification is reviewed annually in order to reflect changes made to the facility since the previous certification and to confirm if the rating is still appropriate under the revised scoring. In this way, DBJ is raising the bar every year and pushing companies to increase their environmental efforts in order to maintain their rating.

By selecting A, B or C rated companies under ERLP and buildings that are rated 5, 4 or 3 stars under GBC programme, DBJ is using the bond proceeds to fund companies/buildings that provide the highest positive sustainability impact.

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<sup>2</sup> [http://www.dbj.jp/en/pdf/CSR\\_disclo/2015/2015\\_all.pdf](http://www.dbj.jp/en/pdf/CSR_disclo/2015/2015_all.pdf)

***In-depth assessment:*** DBJ carries out an in-depth and detailed assessment under its ERLP and GBC programmes in order to rate companies/buildings. DBJ shared with Sustainalytics detailed process information that included process maps and questionnaires that are used to research and collect information, and explained how the assessments are carried out under ERLP and GBC programmes. For example, under ERLP, companies are assessed on 117 questions through interviews, in-person meetings and site visits. These questions address topics such as environmental governance, environmental risk management, environmentally-friendly products, KPI's or measurements for resource use etc.

Similarly, for the GBC, DBJ evaluates buildings on more than 100 questions that include ecology (energy efficiency, resource savings etc.), amenities, risk management (environmental risk, crime prevention, etc.), community impact (impact on surrounding environment) and partnership (tenant education etc.). DBJ dedicates extensive effort and resources to the ERLP and GBC and believes that these efforts encourage and incentivize environmental considerations within companies/REITs in Japan. The companies too are willing to undergo this rigorous assessment and provide detailed information as they not only see this benefiting them financially but also enhancing their reputation in Japan. This is a win-win for the companies and DBJ in promoting environmental stewardship in Japan, which is one of the key objectives of the Sustainability Bond.

#### 4.1 Conclusion

The framework underlying DBJ's sustainability bond is aligned with the four pillars of the 2015 Green Bond Principles – Use of Proceeds, Project Selection Process, Management of Proceeds and Reporting. This assures the robustness of the framework and transparency of the bond. By selecting the top performers under the ERLP and GBC, DBJ's sustainability bond aims to allocate proceeds to companies/buildings that are environmental leaders in Japan.

As a government-owned financial institution, DBJ has the opportunity to take the leadership role in promoting sustainability in Japan, through its financing activities. Through programmes like ERLP and GBC, DBJ has taken this leadership role by encouraging companies and organisations to consider environmental sustainability in their activities. By issuing the Sustainability Bond linked to ERLP and GBC, DBJ is able to further this role and achieve its objective of promoting sustainability in Japan.

## 5 APPENDICES:

### Appendix 1A: ERLP Assessment Topics

| Assessment item           |  |
|---------------------------|--|
| General management        | <b>A Corporate governance</b>                                  |
|                           | <b>B Risk management</b>                                       |
|                           | <b>C Social issues</b>   |
|                           | <b>D Identified material issues</b>                            |
|                           | <b>E Selection of Key performance indicators (KPIs)</b>        |
|                           | <b>F Disclosure of information</b>                             |
| Business activities       | <b>G Environment-friendly products and services</b>            |
|                           | <b>H Environmental considerations in manufacturing process</b> |
|                           | <b>I Environmental considerations in supply chain</b>          |
|                           | <b>J R&amp;D system</b>  |
|                           | <b>K Total assessment</b>                                      |
| Environmental performance | <b>L Measures addressing global warming</b>                    |
|                           | <b>M Measures for effective use of resources</b>               |
|                           | <b>N Measures for water resources</b>                          |
|                           | <b>O KPIs for stakeholder engagement</b>                       |

## Appendix 1B: ERLP Case Study

### Case Study Suzuki Motor

Suzuki Motor Corporation, headquartered in the city of Hamamatsu, Shizuoka Prefecture, has “Small Cars for a Big Future” as its slogan. In line with this mantra, the company has become an industry leader conducting business on the world stage in the production and sale of mini-vehicles, which are light-weight, offer good fuel performance and are low in CO<sub>2</sub> and other emissions. Since the time of its establishment, Suzuki Motor Corporation has made a full-fledged effort to manufacture “valuable products,” working at the same time to promote environmental initiatives throughout the company. Underscoring this emphasis, the company formulated the Suzuki Global Environment Charter in 2002, and has cultivated a particularly high level of environmental management.

DBJ gave Suzuki Motor Corporation the highest rank for the DBJ Environmentally Rated Loan Program and

arranged syndicated loans for the company based on that system.

We accorded Suzuki Motor Corporation a high rating for four reasons. (1) The company has placed a strong emphasis on the environmental effect of its products in use. Applying some of the strictest standards such as Top Runner Standards, the company promotes Suzuki Green Technology, a next-generation environmental technology aimed at reducing weight and fuel consumption. As a result, the company provides products that create new demand, while at the same time addressing an issue facing society. (2) To reach increasing numerical targets for higher global average fuel economy, the company has set key performance indicators (KPIs) for the development of environmental technologies based on a medium-term roadmap. These KPIs lead to the development of next-generation vehicles and improvements in technolo-

gies for enhancing fuel performance. (3) The company conducts monthly environmental effect analyses of each of its production lines and processes, and uses energy cost conversions to measure annual results of introducing equipment. These measures help to ensure the thorough visualization of environmental effects and lead to thorough environmental measures at every plant. (4) In addition to having in place a system to centrally manage the environmental risk of its procurement partners, the company has introduced Suzuki’s Environmental Management System for sales distributors to promote environmental awareness throughout the supply chain.



New ALTO

Source: DBJ CSR Report 2015

## Appendix 2A: GBC Assessment Topics

### Assessment structure

- The three pillars of assessment

The features and characteristics of the green building will be classified into three main categories: (1) **ecology**, (2) **risk management & amenities / diversity**, and (3) **community & partnership**. Each main category consists of five subcategories and has a full score of 100 points. The entire assessment consists of about 60 questions.

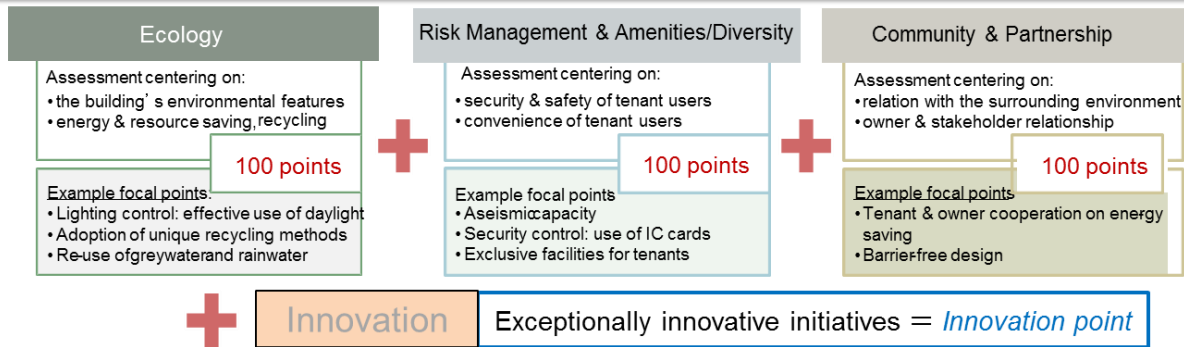
- Comprehensive assessment

Among the conventional assessment points, we have attached particular importance to the **owner operation of the property**, notably as to the points shown below, which adds to the uniqueness of our certification system.

- ◆ In the risk management part, disaster prevention & anticrime measures
- ◆ In the community & partnership part, local environment-awareness initiatives

- Innovation point system

We have adopted an **additional point system to reflect exceptionally innovative initiatives** in each subcategory. Such initiatives need not fit in the scope of the respective questions.



## 6 DOCUMENTS REVIEWED

**Sustainalytics reviewed the following documents for the purposes of writing this report**

| Number | Document Title                     | Comments                             |
|--------|------------------------------------|--------------------------------------|
| 1      | DBJ Green Bond Framework           | Details about the framework          |
| 2      | DBJ ERLP Screening Sheet           | Understand the scoring               |
| 3      | DBJ ERLP Rating Process            | Understand the rating process        |
| 4      | DBJ ERLP Case Studies              | Understand outcome of the assessment |
| 5      | DBJ ERLP Score Distribution        | Analysis of scores                   |
| 6      | DBJ GBC Scoring Sheets             | Understand scoring                   |
| 7      | DBJ GBC Certification Process      | Understand the process               |
| 8      | DBJ GBC Case Studies               | Understand outcome of the assessment |
| 9      | DBJ CSR report 2015                |                                      |
| 10     | DBJ's negative screening document. | Details about exclusionary criteria. |

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